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MANUFACTURERS HANOVER

Financial Digest

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Analysis of Business Trends Plus Selected Financial Indicators

The U.S. Economy Is At a Crossroads

Despite a widespread belief that the seemingly muscular increase in payroll employment in October, accompanied by an acceleration in the pace of average hourly earnings increases, would serve to delay any further easing of monetary policy, the pundits were proven wrong once again. Faced with a pronounced slowing of business activity in several areas of the economy and the virtual collapse of inflation expectations, the Federal Reserve once again eased its monetary stance and prodded interest rates lower. Nor is this step likely to be the last.

It must have been impossible for even the most sanguine member of the Federal Reserve's policy-setting Federal Open Market Committee to ignore the latest signs of economic malaise at last week's meeting. They ranged from a hefty drop in retail sales, to an easing of industrial production, to a softening of factory operating rates. Indeed, some economists would not dismiss entirely doubts that today's soft economic landing might yet become tomorrow's recession. With the economy at a crossroads, the Fed will be on the lookout for further economic weakness, and will respond to forthcoming signs of economic lethargy with additional doses of interest rate relief.

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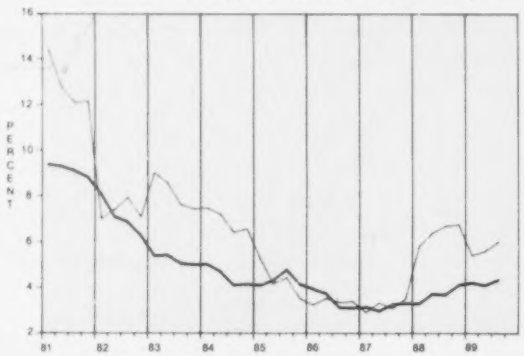
Just a month or so ago, the prospect of interest rate cuts seemed distant. For until recently, opinion concerning the health of the economy had been fairly evenly divided between those who believed that the mounting number of gloomy economic statistics was symptomatic of another of the several temporary lulls which have rejuvenated this aging business expansion from time to time, and those who felt that the spreading weakness posed much greater risks. After all, payroll employment was holding up fairly well, manufactured exports were in record territory, and consumer confidence was high. All of this came together in a seemingly upbeat third quarter estimate of gross national product growth: According to the Commerce Department, the economy expanded at an inflation-adjusted 2½ percent annualized clip—the same as recorded in the second period.

The Minuses Exceed the Pluses

Nevertheless, this backward-looking, preliminary estimate of third quarter growth runs counter to more recent economic evidence. Current statistics seem to be signaling a pervasive economic softness spreading beyond the industrial sector, belying the parallels made with the 1986 slowdown. At that time, export

PRIVATE INDUSTRY WORKERS: WAGES AND SALARIES (THICK) VS. BENEFITS (THIN) (4-QUARTER PERCENT CHANGE)



Source: Bureau of Labor Statistics

and energy-induced industrial weakness was offset by strength in such areas as consumer spending and housing which permitted the economy to dodge the recession bullet. This time around, however, areas of strength are few. The reason that industrial output is faltering, inventories expanding, big-ticket order backlogs ebbing and factory jobs shrinking is not a dearth of foreign demand, but lack of domestic sales. In particular, the consumer appears to be retrenching while housing activity remains depressed.

With the bottom falling out of automobile sales, retail sales fell one percent in October compared with month-earlier levels, the largest month-over-month drop in more than 2½ years. What is more, not all of this weakness can be attributed to autos. Non-auto retail sales virtually flattened last month and, notwithstanding stepped-up spending for such small-ticket items as personal computers and fax machines, raised the specter of a joyless holiday season for retailers.

Nor will housing provide lift to the economy, as it did three years ago. Whereas housing starts held steady in the 1.8 to 1.9 million unit range throughout the first half of 1986, the number of starts in recent months has been running nearly

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one-third lower than that level. This is hardly surprising especially when you consider that new home sales are experiencing their own freefall, dropping 14 percent in September alone.

Interest Rates Head Lower

There is, however, some good news. This is because the slower pace of business evolving economy-wide is consistent with, and to a large extent promotes, general price stability. In turn, this provides the monetary authorities with sufficient flexibility to loosen their grip on the monetary reins without rekindling inflation expectations. In the third quarter, for example, price pressures clearly abated. The GNP implicit price deflator—the broadest measure of inflation available—rose at a 2.9 percent annual rate, well below fourth-quarter 1988's 4.7 percent rise. Nor does there appear to be much inflation heading our way.

For one thing, raw industrial commodity prices, which quickly reflect shifting demand patterns, have plummeted by more than four percent since the beginning of October. For another, producer prices for intermediate goods, indicative of inflation in the "pipeline", were unchanged in October, after declining in three of the preceding four months. Finally, despite a modest acceleration in the growth of average

Short Term Paper Outstanding

(Millions of Dollars)

Time Deposits $100,000 or more Weekly Reporting Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (11/1/89)	218,179	- 2,092	+ 24,182
New York City (11/8/89)	41,933	- 511	+ 935
Commercial Paper (11/8/89)	513,113	+ 2,163	+ 81,174

Bank Loans

(Millions of Dollars)

Commercial and Industrial Loans

Weekly Reporting Large Commercial Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (11/1/89)	321,481	+ 3,624	+ 21,220
New York City (11/8/89)	60,607	- 1,025	+ 4,169

Total Loans and Leases Gross Adjuste

	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (11/1/89)	1,000,920	+14,902	+ 91,977
New York City (11/8/89)	82,209	- 7,396	+ 7,519

Financial Markets

	Friday 11/17/89	Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	7.93%	- .03	- .27
180-Day Bills†	7.86	- .11	- .51
Longest Bills†	7.68	- .13	- .89
Recent Issues:			
8⅛s 10/15/91	7.76	- .22	
8¼s 9/30/93	7.78	- .06	
7⅞s 11/15/99	7.85	NA	
8⅛s 8/15/19	7.92	+ .03	
Municipals:			
Bond Buyer—20 Bond Index* (11/16/89)	7.12%	- .08	- .38
Blue List Total ($ Million)	$1,238	- $188	- $ 246
30-Day Visible Supply ($ Million)	$1,113	- $189	- $ 995
Total	$2,351	- $377	- $1,241
Corporates:			
Moody's Aa Composite (11/16/89)	9.11	- .02	- .66
30-Day Visible Supply ($ Million)	$4,850	- $275	+$3,225
Stocks:			
Dow-Jones Averages:			
Industrials	2,652.66	+ 27.05	+590.25
Transportation	1,191.15	- 12.26	+294.44
Utilities	221.08	+ .13	+ 39.36
65 Stocks	1,007.31	+ 2.83	+225.37
N.Y.S.E. Composite Index	189.28	+ 1.38	+ 39.10
N.Y.S.E. Avg. Daily Vol. for Week (000's)	148,392	- 372	+12,360

*34% Taxable equivalent 10.79%.

† Bond equivalent.

International Rates

EURODOLLAR DEPOSIT RATES (bid)	Friday 11/17/89	Week Ago
Overnight	8.38%	8.38%
1 month	8.38	8.44
3 month	8.38	8.44
6 month	8.19	8.25
1 year	8.13	8.25

FOREIGN EXCHANGE SPOT RATES

New York Opening (11/3/89)	Currency Per U.S. $	Week Ago
Belgium	38.67	38.93
Canada	1.1689	1.1690
France	6.2650	6.2775
Germany	1.8395	1.8605
Italy	1353.50	1356.70
Japan	143.99	143.20
Mexico	2604.00	2599.00
Netherlands	2.0810	2.0900
South Korea	672.30	672.10
Switzerland	1.6340	1.6360
Taiwan	25.95	25.99
U.K.*	1.5745	1.5795

*U.S. $ per U.K. pound

MH TRADE-WEIGHTED DOLLAR (11/17/89) (Adjusted for Inflation)	Change Since Week Ago	Change Since 2/27/85
	+0.1%	-3.1%

hourly earnings in October, wage growth remains remarkably steady. As shown in the chart, wage gains for private industry workers have been stuck in the three to four percent neighborhood for years.

To be sure, such benefit costs as employer contributions to Social Security and health insurance have been rising rapidly and, in the third quarter, were six percent higher than a year ago. But, here, too, the inflation impact has been muted. With consumer resistance to higher prices fierce, firms have found themselves trying to pass along a large chunk of these higher benefit costs—not to the consumer, but to their employees. The results have been mixed, with success in some industries, but work stoppages in others.

The becalmed inflation environment provides the Fed with a window of opportunity to respond to today's economic slowdown without undue hesitancy. Short-term interest rates have already moved a notch lower and money supply growth has quickened. However, since the signature of the Alan Greenspan Fed has been to move cautiously, pausing after each step to examine the latest-breaking information, interest rates will slowly zig-zag their way lower in coming months, rather than nose-dive abruptly. ■

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending 11/15/89	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit			
U.S. Gov'ts and Agencies Owned Outright & RPs	221.415	- 1.862	- 14.734
Loans to Depository Inst.	.341	+ .137	- 3.159
Float	1.206	- .011	+ .037
Total Reserve Bank Credit	261.245	- 1.457	+ 1.737
Treasury Deposits with Federal Reserve Banks	4.757	- .604	- .452
Currency in Circulation	251.338	+ 1.208	+10.712
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	236.514	+ 1.799	+ 7.012
	11/15/89		
Member Bank Reserves:			
Total Reserves Held	59.823	+ 1.176	- 2.147
Excess (Deficiency)	.763	- .367	- .840
Net Free Reserves	.510	- .298	- .698
Monetary Aggregates †		**‡ % Change Since 3 Months Ago***	**Year Ago**
M1 (11/6/89)	788.3	+ 5.7	+ 0.2
M2 (11/6/89)	3,190.3	+ 7.5	+ 4.4
M3 (11/6/89)	4,035.7	+ 2.5	+ 3.8
Domestic Nonfinancial Debt (2nd Q'89)	9,427.7	+ 6.4	+ 8.5

† Seasonally adjusted. * Seasonally adjusted annual rate. ‡ Four-week moving average.

New York Money Market

Offering Rates 11/11/89	3 Months	6 Months	1 Year
‡ U.S. Treasury Bills	7.68%	7.47%	7.18%
* Federal Agencies	8.38	8.20	8.10
* Municipal Notes–High Grade (34% Taxable Equivalent)	7.95	8.33	8.71
Negotiable Time CDs			
Manufacturers Hanover	Rates By Arrangement		
* Secondary Market–Prime	8.40	8.25	8.00

‡ Finance Company Paper–Prime		‡* Bankers' Acceptances	
5- 14 days	8.38%	Dec.	8.36%
15- 29 days	8.35	Jan.	8.35
30- 59 days	8.30	Feb.	8.20
60- 89 days	8.20	Mar.	8.05
90-179 days	7.97	Apr.	7.93
180-239 days	7.55	May	7.93
240-270 days	7.55		

‡ Industrial Paper–Prime			
30- 89 days	8.35%	†Federal Funds Effective Rate	8.38%
90-120 days	8.28		

‡ Discount basis. *Subject to availability. † Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	3rd Q'89	$ 5,273	$ 5,202	$ 4,927
Gross National Product (1982 Dollars)*	3rd Q'89	$ 4,158	$ 4,133	$ 4,043
Percent Change, Annual Rate	3rd Q'89	2.5	2.5	3.2
Change in Consumer Prices*	Sep '89	2.4%	0.0%	4.8%
Change in MH Cost of Living Index*	Sep '89	6.0%	1.2%	8.4%
Change in Producer Prices*	Oct '89n	4.8%	10.8%	1.2%
Civilian Employment (Thousands of Persons) †	Oct '89	117,545	117,456	115,573
Unemployment as % of Civilian Labor Force †	Oct '89	5.3%	5.3%	5.3%
Personal Income*	Sep '89	$ 4,469	$ 4,456	$ 4,119
Leading Indicators Composite Index (1967=100) †	Sep '89	145.0	144.7	143.7
Industrial Production Index (1977=100) †	Oct '89n	141.4	142.4r	139.4
Net Change in Consumer Installment Credit †	Sep '89n	$ 0.61	$ 2.66r	$ 1.89
U.S. Merchandise Trade Balance †	Sep '89n	- $ 7.94	- $ 10.10r	- $ 9.17
Plant and Equipment Expenditures*	4th Q'89	$483.04(a)	$ 481.24(a)	$442.11
Private Housing Starts (Thousands of Units)*	Oct '89n	1,420	1,268 r	1,532
New Construction Expenditures*	Sep '89	$ 415.6	$ 415.8	$ 411.5
Total Business Inventories †	Sep '89n	$ 791.8	$ 790.4r	$ 744.0r
Total Business Sales †	Sep '89n	$ 524.6	$ 526.3r	$ 491.6r

*Seasonally adjusted annual rate. † Seasonally adjusted. n-Newly reported figure. r-Revised. a-Anticipated.